COMPARATIVE ANALYSIS ON RISK MANAGEMENT PRACTICES AMONG SELECTED COOPERATIVE BANKS AND RURAL BANKS IN CAGAYAN

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ABSTRACT

This descriptive study aimed to conduct a comparative analysis on the Risk Management Practices of selected Cooperative Banks and Rural Banks operating in Cagayan. Cooperative Banks and Rural Banks are small banks that are susceptible to the greater amount of risks. Administration of questionnaires and conduct of interviews were the data gathering methods used. The study participants were bank managers, head of risk management department and any person who have direct knowledge of risk management of the banks where they are employed. Frequency Count and Percentage, Weighted Mean and Kruskal–Wallis Test were utilized as data analysis. From the findings, results revealed that majority of the banks are Rural Banks. In addition, majority of the banks are dominated by vast regional banks in the market coverage. Cooperative banks in Cagayan have a "very high" understanding of risk and risk management, while rural banks have a "good level" of understanding. Audit and physical inspection were the highest risk identification method used for cooperative and rural banks. Among the banks common risk management practices involved, namely; managing risk; risk assessment and analysis; and risk management process. Kruskal-Wallis test showed no significant difference on the level of understanding of the participants on risk management when grouped according to profile. Moreover, Kruskal-Wallis test revealed no significant difference in the risk management practices of banks. Thus, Banks in Cagayan whether Rural or Cooperative in nature utilizes risk identification methods. Both Cooperative Banks and Rural Banks find it difficult to identify and classify its main risk.

Keywords: *Risk management, risk management practices, rural banks, cooperative banks*

INTRODUCTION

Financial crisis, which every country is facing right now, gives an understanding that risk is just present everywhere making financial institutions employ risk management practices. Banks, for example, are exposed to two factors in facing risks. These are the external factors and internal factors. External factors are those beyond the control of the organization such as the technological, political, economic and social environment. On the other hand, the internal factors are those that take place within the organization which is manageable through proper implementation of management policies, procedures and practices. A successful bank environment can adopt changes both for external and internal aspects, following the ability to require constant attention in establishing and employing the risk management practices. Risk Management is composed of a set of processes which, when followed strictly may bring wellness to the organization. The Risk Management Process includes risk identification, risk assessment, risk monitoring, and risk control. Cooperative Banks and Rural Banks are differentiated from each other by ownership. Rural Banks are privately owned and managed by an individual or group of investors while Cooperative Banks are organized and owned by a joint cooperative, federation of organizations and members represented as co-owners of the cooperatives.

According to Philippine Deposit Insurance Corporation over the past five (5) years (2008 – 2012), a total of one hundred seventeen (117) rural banks and seven (7) cooperative banks, or a total of one hundred twenty-four (124) Rural and Cooperative Philippine banks failed in their operation. As reported, some of the banks failed mainly due to bad real estate mortgage loans and unmanageable liabilities. Cooperative Banks and Rural Banks are designed to cater to the needs of the rural areas, specifically the credit needs of poor consumers, small producers, fisher folks and farmers.

Cooperative Banks and Rural Banks provide numerous contributions in the banking industry of the country. A sustainable and stable economy reacts unto the stability of the banking operations. With their participation and the type of market that the bank caters, the risk of engaging in this kind of business is high risk. In the Philippine setting, the country experiences an average of nineteen (19) typhoons in a year; the country also suffers drought, landslides, floods, and other natural disasters which mainly affect the local farmers, fisher folks, small producers and consumers. Another point to emphasize is the human factor that manipulates and runs the business on a daily basis. The disasters and the human factors which drive the movement of risks and risk outcomes from this type of business gives valid justification on the data provided by the Philippine Deposit Insurance Corporation for the last five (5) years. There are no big or small banks when it comes to risk. Everyone, when the business drives changes, banks must be able to respond to the threats of risks quickly. Indeed, the funds to be allocated to the risk management department or committee by the organization would be at a high cost but, it would create a greater mismanagement if it is not one of the bank's main concerns. Financial institutions need various reforms and revisit their risk management practices. Regardless of what enjoyment and engagement as to stability in the daily operation, it would surprise if a sudden loss, risk undertaking and unforeseen events would happen. Thus, the study aims to undertake a comparative analysis on the risk management practices of selected cooperative banks and rural banks operating in Cagayan.

Conceptual Framework

This study aimed to conduct a comparative analysis on the Risk Management Practices of selected Cooperative Banks and Rural Banks operating in Cagayan. Cooperative Banks and Rural Banks are small banks that are susceptible to the greater amount of risks.

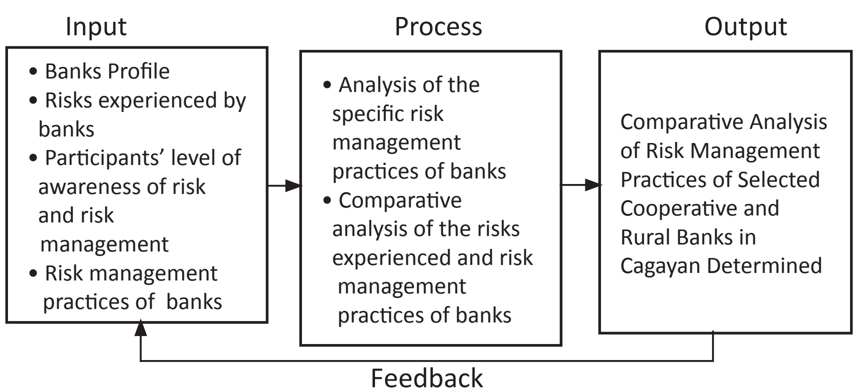

Figure 2: Paradigm of the Study

The study undertook a comparative analysis of Risk Management Practices of Selected Cooperative Banks and Rural Banks in Cagayan. As shown, the banks profile, risk experienced by banks, participants' level of awareness of risk and risk management and risk management practices of the banks. Processes involved were the analysis of the specific risk management practices of banks and comparative analysis of the risks experienced and risk management practices of banks. Hence, the study assessed and determined which bank has a better risk management practices regarding risk identification, risk assessment and analysis, and risk monitoring and risk control.

Statement of the Problem

The study aimed to conduct a comparative analysis on the Risk Management practices of selected Cooperative Banks and Rural Banks operating in Cagayan.

Specifically, the study attempted to answer the following:

1. What is the profile of the banks according to their classification, market coverage and years of operations?

2. What is the level of understanding of the participants regarding risk and risk management?

3. To what extent do Cooperative and Rural Banks practice risk management in the following areas:
    3.1 Risk identification methods being practiced;
    3.2 Risk identification process;
    3.3 Risk assessment and analysis; and
    3.4 Risk monitoring and control?

4. What are the different risks experienced by Rural and Cooperative Banks in Cagayan?

5. What are the similarities and differences in the risk management practices of the Cooperative Banks compared to Rural Banks?

6. What are the best practices on Risk Management among Rural and Cooperative Banks in Cagayan?

METHODOLOGY

Research Design

The researcher employed the descriptive research design because the study was concerned about the status of selected Cooperative and Rural Banks in Cagayan. With respect to risk management, the study specifically documented the level of understanding of the bank personnel on risk and risk management and the banks' practices along risk management as well as their risk experiences.

Participants of the Study

The participants of this research study were the bank managers, branch heads, heads of risk management department or division or any person who has a direct knowledge of the risk management practices of Cooperative and Rural Banks in Cagayan. There were six (6) identified banks in this research study, four (4) of the participants are categorized as Rural Banks, and two (2) are classified as Cooperative Banks.

Instrumentation

To gather the primary data needed in this research study, the researcher used the questionnaire and interview methods. Documentary analysis of banks, circulars, journals and handbooks gearing on the banks risk management practices were undertaken. The first part of the questionnaire elicits on the profile of the participants. A modified version of the questionnaire developed by Al-Tamimi and Al-Mazrooei (2007) and Hassan (2009) was also used to collect the data for this study. The questions focused on understanding risk and risk management, areas of risk management such as risk identification, risk assessment and analysis, and risk monitoring and control as well as their practices along risk management.

Data Gathering Procedure

In pursuit of the objectives of this study, the researcher collected the data through the following procedures:

1. A letter of permission was given to the bank manager for the floating of questionnaire and conducting interviews.

2. Development and validation of questionnaires through the help of the expert on risk management.

3. Administration of questionnaires and conduct of interviews.

4. Documentary analysis on the level of understanding of the bank personnel on risk and risk management, banks' practices along risk management as well as their risk experiences.

Data Analysis

In the treatment of data, the researcher utilized the following statistical tools.

1. Frequency Count and Percentage. This was used to determine the profile of the business; risk experienced and risk management practices of the participants.

2. Weighted Mean. This was used to determine the level of awareness and extent of practices of the participants on the risk identification techniques.

3. Kruskal–Wallis Test. This was used to determine the significant difference in the extent of use of the Risk Management Practices when grouped according to profile variables.

RESULTS AND DISCUSSION

Profile of the Bank

Four (4) of the banks under study are rural banks while two (2) are cooperative banks. This data showed the ratio of Rural Banks and Cooperative Banks in Cagayan.

Three (3) of the banks are within the regional market coverage of operation. This shows that majority of the banks serve the financial needs of the target clients in a region-wide scope.

Four (4) of the banks have been operating for 1 – 25 years. This showed that the banks are still in the midst of their operation for better purposes.

Level of Understanding Risk and Risk Management

Participants' mean responses for Cooperative Banks range from 4.00 – "great understanding" to 5.00 – "very great understanding". The mean responses for Rural Banks in Cagayan range from 3.50 – "great understanding" to 4.75 – "very great understanding". Based on the results, Cooperative Banks in Cagayan scored better than the rest of the banks as to level of understanding risk and risk management. The mean results of Rural Banks in Cagayan shows that they do have an effective risk management strategy, that the stress testing output understood by its management and board and that cruciality for the bank to apply sophisticated techniques in risk management in its entire operation are understood only to a great level compared to other components.

Risk Management Processes

The highly rated risk identification method used for Cooperative Banks and Rural Banks in Cagayan is the audit and physical inspection with a mean of 5.00 and 4.50, respectively, both of which are within "very great extent" of use. The highest mean listed by Cooperative Banks and Rural Banks in Cagayan, represents the compliance of annual supervision of Bangko Sentral ng Pilipinas regarding capital adequacy that banks should maintain and the requirement they needed to comply annually. Both banks have lowest average mean of 3.50 and 3.25, respectively, or “great extent” in scenario analysis. Scenario analysis is a process to ascertain and analyze possible events that can take place in the future. Therefore, the need for financial planning and forecasting in bank finances provides an effective way in managing future unexpected financial problems.

On the responses as to the extent of the Risk Identification process used by Cooperative Banks and Rural Banks in Cagayan, risk identification is the process in managing risks. The least response for Cooperative and Rural banks in Cagayan is for the statement “The bank finds it difficult to identify and classify its main risks” with an average mean of 3.00 or “moderate extent” and 2.75 or “moderate extent,” respectively. The results indicate that due to changing environment factors of the banks such as economic, technological, social and political factors the banks also find it difficult to identify as to what risk they experienced. Overall, these results indicate that Cooperative Banks in Cagayan have a better practice on different risk identification which gives an overall mean of 4.22 or “very great extent,” while Rural Banks have an overall mean of 3.81 or “great extent.”

All responses for both banks have the same qualitative description of “very great extent” except for the statement “It is a policy in our bank to use risk management techniques as management tools” which cooperative banks obtained a mean rating of 4.50 or “very great extent” while rural banks have a mean rating of 4.00 or “great extent”. Once the risks are identified, it is helpful for the organization to categorize the risk (e.g. internal risk, external risk, controllable risk, non-controllable risk) for better assessment and analysis. The bank may face a hundred types of risks, and it requires that risk is not just understood by a single unit within the organization. After which, the next step for the organization is that the bank should rank it from highest to lowest; then prioritize according to importance. Risk management techniques used as management tool would be debatable because of the different factors experienced during the time of assessment and analysis (e.g. crisis experience, hazard that happen to a certain city, municipality or province); or it would be subjective in terms of the data tracking, recording and consistency of the risk experience. This process in risk management gives a valuable importance in the banks' ability to address the probability of risk occurrence. Indeed, banks assess the likelihood of risk occurring because return on equity is their biggest concern.

The Cooperative Banks gave a "very great" emphasis on the recruitment of highly qualified people who have a direct knowledge on risk management while the Rural Banks provided a "great" emphasis on the same recruitment practice. Therefore, the researcher supports that the data are still reliable even if there is inconsistency with the responses of the participants. Overall, these results indicate that Cooperative Banks have a better practice on different risk monitoring and control than Rural Banks.

Risk Experienced by Cooperative and Rural Banks in Cagayan

Both Cooperative Banks and Rural Banks have experienced credit risks in their respective daily operations. Particularly, they experience this risk because these banks serve as an intermediary between the users (debtors) and savers (creditors) of money and credit. Considering that the customers they cater to are mostly engaged in agricultural and industrial activities. On the other hand, Cooperative banks experienced interest rate risk. The reason is due to different market forces and economic activities which trigger the movement of interest rate locally and internationally. Rural banks experienced operational risk, a risk of negative effects on the financial result and capital of the bank caused by omissions in the work of employees, inadequate internal procedures and processes, inadequate management of information and other systems, and unforeseeable external events.

Similarities and Differences in Risk Management Practices of Cooperative Banks and Rural Banks in Cagayan

Personnel In-charge

It showed that Rural Banks give more focus on credit and market risk management while Cooperative Banks focus on credit, market and operational risk management.

Involvement of Board of Directors

Rural Banks have a greater risk exposure than Cooperative Banks in Cagayan regarding the participation of the Board of Directors more specifically in their participation in audit committee.

Identification of Risk using Different Performance Key Indicator

Both Cooperative Banks and Rural Banks ensure that key performance indicators are used as bases in identifying risks in their operation.

Procedures in Granting Loans

Both Cooperative Banks and Rural Banks performed the following before granting credit to their clients: (a) Analysis of the Purpose of Credit and Sources of Repayment, (b) Conduct Background Investigation, (c) Require Borrowers' Collateral, (d) Consider Economic Situation and Condition, (e) Study Borrowers' Repayment History, and (f) Study Barrowers' Capacity to Repay.

Frequency of Banks in Reviewing Risk Management Procedures

Cooperative Banks and Rural Banks are experiencing a low level of risk exposure as to reviewing their internal operations since there is continuity in monitoring and updating of reports.

Internal Operation of Banks

One of the bank-participants in the study does not have a risk management committee because 50% of its employees are family members and holding key positions in the bank. The Cooperative Bank is consistent as to the non-involvement of the Board of Directors in the audit committee, while Rural Banks involved the Board of Directors in the audit committee.

Best Practices for Risk Management of Cooperative Banks and Rural Banks

Based on the documented responses of the participants, the following appeared to be the pattern why Cooperative Banks and Rural Banks have a very satisfactorily risk management practices. The primary key indicator, to integrate a best practice, is to communicate the risk management from top management to bottom. Through effective communication in a sound regular basis, the risk management processes, risk identification, risk analysis, risk monitoring, and risk control would be successfully implemented. Successful risk management processes follow risk prioritization, updates and education of information throughout the organization.

Significant Difference on the Level of Understanding Risk and Risk Management of the participants when Grouped according to Profile Variables

Kruskal-Wallis test showed no significant difference on the level of Understanding Risk and Risk Management of the participants, when they are grouped according to the classification of the bank they are employed with, market coverage and years of operation.

Significant Difference in the Risk Management Practices of the Participants when Grouped according to Profile Variables

Krusal-Wallis test showed no significant difference in the Risk Management Practices of the participants regarding Risk Identification Methods, Risk Identification, Risk Assessment and Analysis, and Risk Monitoring and Control when they are grouped according to the classification of the bank, market operation and years of operation.

CONCLUSION

The risk management assessment and analysis of Cooperative Banks are more efficient than those of Rural Banks. The risk monitoring and control of Cooperative Banks are more effective than Rural Banks. Both

Cooperative Banks and Rural Banks in Cagayan find it difficult to identify and classify its main risk. The non-involvement of the Board of Directors in managing risk and implementation of risk policies lead the Rural Banks to a higher risk exposure. Rural Banks and Cooperative Banks are exposed to high risk in the internal audit because of the involvement of the Board of directors in the audit committee. Credit risk is a common type of risk experienced among Cooperative Banks and Rural Banks. Furthermore, Cooperative Banks experience low-risk exposure than Rural Banks in Cagayan. Both banks somewhat have no alternative control measures to a particular risk.

RECOMMENDATIONS

Based on the findings and conclusion of the study, the following recommendations are drawn:

The banks may consider establishing an appropriate credit risk environment which requires the Board of Directors to have responsibility for reviewing and approving credit risk strategy and risk management policies of the Bank.

Cooperative Banks and Rural Banks may look into the effectiveness of communication from the top management down to its employees so as to identify areas with high-risk exposure and to formulate controls and strategies to mitigate the effects of identified risks.

Cooperative Banks and Rural Banks may clearly set out its risk implementation in its operation of Risk Management practices and policies, and should be understood from top management down to the bottom.

The personnel in the organization should be well-informed and knowledgeable in identifying, analyzing, assessing, monitoring and controlling risk.

Cooperative Banks and Rural Banks may continuously identify the different risks experienced.

Cooperative Banks and Rural Banks may update and revisit their risk management plans, strategies, policies, and procedures a sound regular for a low percentage of risk occurrence.

The Board of Directors of Cooperative Banks and Rural Banks need to strengthen their oversight function particularly in the implementation of risk policies and always involve themselves in formulating policies and procedures at all times at a regular interval.

The Board of Directors may provide an approach in credit control as to granting and managing credit application, to ensure a positive risk–return trade-off, capital adequacy as well as maximizing profits in the long run.

Additional researches may be conducted about risk, risk management and risk management practices of banks.

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